

United States v. Deutsche Bank and MortgageIT
Prepared Remarks of U.S. Attorney Preet Bharara
May 3, 2011

Good afternoon. My name is Preet Bharara, and I am the United States Attorney for the Southern District of New York.

Under the authority of the False Claims Act and other laws, the Government today sues Deutsche Bank and its wholly-owned subsidiary, MortgageIT, for years of reckless lending practices.

As alleged, these companies repeatedly and brazenly breached the public trust. This lawsuit sends them – and other lenders – the message that they cannot get away with lies and recklessness. They cannot casually assign the prospect of being caught to the cost of doing business.

Accordingly, with this lawsuit, the Government is seeking treble damages, the maximum civil penalties, future damages, and punitive damages for a pattern of reckless lending practices, a pattern that occurred over a period of years and all over the country.

The complaint describes, in detail, lenders taking abusive advantage of a vital Government mortgage insurance program, issuing billions in loans to countless aspiring homeowners.

But while the homes the defendants issued loans for may have been built on solid ground, the defendants' lending practices were built on quicksand.

Borrower after borrower defaulted – often within just months of closing – because those loans were doomed to fail.

Why? Because, as alleged, the defendants simply ignored every type of red flag and breached every duty of due diligence before endorsing mortgages for federal insurance.

In fact, they seemed to treat red flags as if they were green lights.

Ultimately, prudence was trumped by profit, and good faith took a back seat to good fees. Today, we hope that calculus changes.

Before I go any further, let me introduce and thank the partners standing with us today:

- Dane M. Narode, the Associate General Counsel, HUD Office of Program Enforcement
- Rene Febles, Special Agent in Charge, HUD Office of Inspector General in New York

I am also joined by members of my Office's Civil Frauds Unit, which oversees our civil fraud investigations, including mortgage fraud investigations like this one, and which is handling this suit: Assistant United States Attorney Brian Feldman, along with Chief of the Civil Frauds Unit, Heidi Wendel, Deputy Chief Lara Eshkenazi, and paralegal David Farber.

I established the Civil Frauds Unit last year to bring renewed focus and additional resources to combating financial fraud, including the type of fraud alleged today.

Now, let me go back to explaining the allegations in the complaint we have filed.

In order to understand the nature and significance of the allegations, it is important to understand the Direct Endorsement Lender program, run by the Department of Housing and Urban Development (HUD), which includes the Federal Housing Administration (FHA).

In a nutshell, here is how it worked.

The program depends on “direct endorsement lenders” whom the Government entrusts with an essential public duty. These lenders are deputized to approve, or endorse, mortgages for insurance.

In exchange, their job is to review mortgages to determine whether the risks exceed Government standards. They make a promise that every loan they endorse complies with HUD rules, rules aimed at ensuring that homeowners can realistically make their mortgage payments. Those mortgages are then insured by the federal government against default.

In order to qualify for this privileged status as a “direct endorsement lender,” financial institutions must meet quality control standards, commit to due diligence, and certify the quality of each and every mortgage they endorse.

But, as today’s lawsuit describes, the defendants never held up their end of the bargain – neither MortgageIT when it was acting alone from 1999 to 2006, nor Deutsche Bank when it acquired MortgageIT and carried on its business until 2009.

Instead, they indulged in the worst of the industry’s reckless lending practices. While they promised to select qualified mortgages to be insured, they repeatedly abused that public trust by brushing aside the rules, lying about the quality of their underwriting operation, and passing on the costs of the inevitable hundreds of millions of dollars of defaults to the Government.

It wasn’t their problem anymore; the Government held all the risks and, ultimately, was left holding the bag.

More than 14,000 of these bad loans ultimately defaulted. As a result, the Government has so far paid more than 3,100 insurance claims, totaling \$386 million. Of that, nearly \$100 million was paid, for more than 600 mortgages that defaulted within just six months of closing. And the Government will be forced to pay even more in the future, as MortgageIT endorsed more than 39,000 mortgages for Government insurance, totaling more than \$5 billion in underlying loans.

As we allege, corporate culture led to the collapse of lending standards. Most tellingly, the defendants repeatedly lied to HUD about the implementation of quality control procedures.

Their recklessness is well-documented in the complaint.

Let me further mention three quick and specific examples of the type of recklessness we are talking about.

First, a critical part of quality control for lending is the review of early payment defaults. If borrowers are defaulting right away – say, within six months – that is a critical red flag. Review of those red flags is an early warning system for problems in the underwriting process, as early defaults are an indicator of possible mortgage fraud. That's not only simple common sense; it was also mandatory for participation in the insurance program we're talking about here.

But, as alleged, MortgageIT utterly failed to review early payment defaults. That failure, of course, helped to perpetuate a pattern of defaults going forward.

Second, MortgageIT blithely ignored red flags in the form of outside audit reports. As set out in the complaint, an employee of MortgageIT had repeatedly signed off on shoddy loans, which were not eligible for federal insurance. An outside auditor finally called attention to her practices.

But that auditor's findings were – remarkably – stuffed in a closet, unopened and still sealed, for months. And even after a new manager finally found the proverbial skeleton in the closet and read it, upper management still did nothing.

Third, as specified, MortgageIT often did not undertake even the most basic forms of due diligence, like confirming that the borrower had a job. In one case documented in the complaint, a borrower defaulted just four months after the closing. That doesn't come as too much of a surprise – because it turns out that the borrower never worked for the listed employer. But MortgageIT never even bothered to pick up the phone.

In short, this reckless behavior – the failure to implement the lending standards required by the FHA program – led the Government to foot the bill for many mortgages doomed to fail – mortgages that were, really, ticking time bombs.

The FHA is a vital program, and direct endorsement lenders are critical to its success. The work they do is important to ensuring that millions of Americans can purchase homes.

That is why lawsuits like today's are so important – they are just as important to ensuring the future strength of the mortgage market as they are to punishing past abuses in that market.

The Federal Housing Administration is the largest insurer of mortgages in the world. And its market share is only increasing.

In fact, FHA currently insures one of every three new residential mortgages in America. That's up from just 4 or 5 of every hundred only a few years ago. That means that FHA is becoming a more and more important pillar of the entire housing market.

And that, in turn, means that the type of cheating and churning described in today's lawsuit is unacceptable going forward.

Every lender in America needs to be on notice that – more than ever before – we cannot tolerate fraud and misconduct in the mortgage market.

In order to prevent another crisis tomorrow, we all need to be even more vigilant today.